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BEFORE THE

SURFACE TRANSPORTATION BOARD

Ex Parte No. 646 (Sub-No. 1)

RAIL RATE CHALLENGES IN SMALL CASES

REBUTTAL COMMENTS OF

THE DOW CHEMICAL COMPANY

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Dated: January 11, 2007

**REBUTTAL COMMENTS OF
THE DOW CHEMICAL COMPANY**

The Dow Chemical Company ("Dow") hereby submits rebuttal comments in the above-captioned proceeding. In its opening comments, Dow commended the Board for initiating this proceeding, but explained that the Board's proposals fall far short of offering effective and meaningful rail rate regulation and in fact would create a worse situation than exists under the current standards. Dow commented generally on the proposed Simplified Stand-Alone Cost ("SSAC") proposal and the refinements to the existing three-benchmark approach, but focused its comments principally on the Board's proposed criteria for determining eligibility to use these rate standards. Dow adopted the joint comments filed by several trade associations, including the American Chemistry Council, of which Dow is a member ("Joint Commenters").

In these rebuttal comments, Dow responds to various comments made by the railroads in their reply comments. Dow also adopts the reply and rebuttal joint comments filed by the Joint Commenters.

I. Simplified SAC is an Unnecessary and Unwarranted Deviation from the Three-Benchmark Standard.

Dow remains very concerned that the Board's proposals will create a worse situation than has existed for the past 10 years, since *Rate Guidelines—Non-Coal Proceedings*, 1 S.T.B. 1004 (1996) ("*Non-Coal Guidelines*"), in which the Board adopted the three-benchmark approach as the standard for small rate cases. That decision, however, left many unanswered questions as to how the Board would apply the three-benchmark approach and when a case would qualify as a small case and thus be eligible to use the three-benchmark approach. The resulting uncertainties created a chilling effect that discouraged any small rate case challenges at all. Since then, Dow and others repeatedly have requested clarification and guidance from the Board on the three-benchmark approach. Instead, the Board has created an entirely new, more costly, more time consuming and more complex approach in SSAC that will exacerbate the chilling effect of the past 10 years.

The Joint Commenters have illustrated the cost and complexity of SSAC in their opening and reply comments. Moreover, they have demonstrated how the proposed SSAC methodology inevitably will produce rates that are higher than a Full-SAC case, and potentially much higher. The railroad commenters generally support the SSAC proposal in its entirety, except for some modifications that would add even more cost and complexity. The unqualified railroad support for SSAC, as proposed by the Board, combined with the unanimous opposition of the shipping community to SSAC should raise serious red flags with the Board indicating that its proposal heavily favors the railroads.

In *Non-Coal Guidelines*, the Board rejected an SSAC proposal supported by the railroad industry because it was inconsistent with Constrained Market Pricing ("CMP") and biased toward the railroads in its assumptions. 1 S.T.B. at 1012. The Board noted that SSAC was not based on a fully efficient system and thus failed a basic purpose of CMP to determine the cost of an optimally efficient system, which biased the SSAC model in the railroads' favor. *Id.* at 1015. The Board's currently-proposed SSAC methodology suffers from this same fatal flaw by requiring complainants to use the incumbent's existing traffic base and infrastructure for the stand-alone railroad.

The STB also rejected the SSAC model in *Non-Coal Guidelines* because it generated absurd results in testing. 1 S.T.B. at 1016-17. But in this proceeding, the Board proposes to adopt an even more complex SSAC methodology without any testing. Since SSAC inevitably produces higher rates than Full-SAC, testing is essential to determine how much higher than Full-SAC SSAC would set rates in order to ensure that SSAC does not deprive shippers of protection against unreasonable rates. The Board has information from previous Full-SAC cases against which it could benchmark the results of an SSAC case for the same traffic.

Neither the Board nor the railroad commenters have demonstrated that SSAC truly is a simplified variation upon Full-SAC that preserves the essence of CMP. As the Joint Commenters have demonstrated, SSAC adopts and simplifies only those portions of CMP that will increase railroad costs, while disregarding those portions that lower costs by developing the most efficient stand-alone railroad for the selected traffic group. Thus, it is not at all clear that SSAC implements CMP at all, much less in a truly simplified and less costly manner.

II. The Board Should Refine the Three-Benchmark Approach for All Small Rate Cases.

In response to shipper requests for clarification of the three-benchmark approach, the Board instead has all but abandoned that standard in favor of SSAC. Both the Board and the rail industry are too quick to abandon the three-benchmark approach, without any demonstrated reason for doing so.

The overall concern expressed with the three-benchmark approach is that it is not premised upon CMP. But, in *Non-Coal Guidelines*, the Board flatly rejected the railroad industry's "underlying assumption that CMP is susceptible to adequate simplification without losing its effectiveness, and that other (non-CMP) simplified procedures cannot be considered." *Id.* at 1021. The Board also noted that "other procedures can, and indeed must, be made available for those cases in which CMP simply cannot be used—because the traffic is so infrequent or widely dispersed that it is not susceptible to a SAC presentation or because the case is so small in value that the substantial expense of a CMP presentation...cannot be justified." *Id.* These conclusions remain true today. As demonstrated by shipper comments in this proceeding, the Board's SSAC proposal is too complex, costly and time-consuming to extend any more meaningful rate protections to most captive shippers than Full-SAC has offered.

As the Board held in *Non-Coal Guidelines*, "[a]ccuracy must be sacrificed for simplicity...to ensure that no shipper is foreclosed from exercising its statutory right to challenge the reasonableness of rates charged on its captive traffic." *Id.* at 1008. The Board concluded that the three-benchmark approach "provide[s] an appropriate frame of reference for our rate reasonableness analysis [and] properly introduce[s] all of the factors that must be looked at in our analysis." *Id.* at 1020. Neither the Board nor any commenter has presented any reason to reconsider those holdings now.

The railroad commenters seem to anticipate a deluge of complaints under the three-benchmark approach that would bring the walls of revenue adequacy crashing down upon them if the Board abandons SSAC. But, in *Non-Coal Guidelines*, the Board "expressed confidence that reliance on a cruder method would not significantly affect a carrier's overall ability to earn adequate revenues, because only a very small portion of rail traffic could be subjected to rate reasonableness review using such simplified procedures." *Id.* at 1008-09. This conclusion was based on an assessment that most traffic would not even be eligible for rate regulation due to the market dominance requirement, contracts, and exemptions. In the decade since the Board reached this conclusion, no deluge of complaints has occurred. Furthermore, the railroads have pointed to nothing in the Board's proposed refinements to the three-benchmark approach that suddenly would open up the flood gates.[1]

Nor is there any evidence that the three-benchmark approach will result in rates that hinder the attainment of revenue adequacy. Indeed, as railroads have raised rates even on their

[1] While certain clarifications as to eligibility requirements could make more shippers willing to file small cases, there is no evidence that any increase would be substantial, much less the overwhelming deluge that the railroads purport to fear.

competitive traffic, this will be reflected in the comparable traffic group used in the three-benchmark approach. Moreover, if, as the railroads claim, most of their traffic is in fact competitive, the three-benchmark approach will not impact enough traffic to create a circularity that causes rates to spiral downward, since the higher rates on the more prevalent competitive traffic will more than off-set any downward pull. Furthermore, even for commodities that are not susceptible to extensive competition, the RSAM and R/VCtotal adjustments to the comparable rates inject an upward bias to the comparable group rates until revenue adequacy is achieved.

If the Board is interested in establishing "a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case," 49 U.S.C. § 10701(d)(3), that is truly meaningful, then it should focus on refining the three-benchmark approach and clarifying the eligibility standard, rather than venturing into the uncharted and choppy waters of SSAC. The Board can adopt a refined three-benchmark approach (with reasonable eligibility standards as described herein) and monitor the volume, scope, nature, and substance of such cases to assess the adequacy of protection offered to captive shippers and the impact upon the railroads. There is no reason to accept at face value railroad claims that the three-benchmark test will be ruinous to their financial health, since it is highly improbable that enough cases could or would be filed at one time to realize even the railroads' worst fears. If signs of problems arise, the Board can reopen this docket to address them.[2]

It would be imprudent for the Board to accept the railroads' exaggerated predictions of doom under the three-benchmark standard, when those predictions can be tested with very little

[2] During this period, the Board could continue to evaluate SSAC through testing and refinement. If the Board later concludes that the three-benchmark approach is not working and it can address the major problems with SSAC, perhaps SSAC might then be ready for deployment.

risk to the railroads. In contrast, the risk to shippers is great, since shippers who have not filed rate complaints due to the uncertainties of the three-benchmark approach will find the more complex and costly SSAC approach to be even less responsive to their needs.

Only in recent years, as railroads have imposed unprecedented rate increases, have the stakes been raised to such a level that any captive shipper has been willing to brave the uncertainties surrounding the three-benchmark approach to file a small rate case. Even then, there have been a total of two complaints in as many years. But, just as the three-benchmark approach is being tested in real cases for the first time, the Board has proposed to turn back the clock by adopting SSAC, which is a radically more complex, costly and time consuming approach that is untested, thereby imposing even greater risks and uncertainties upon potential complainants than those that have existed under *Non-Coal Guidelines* for the past decade.

III. The Railroads' Refinements to the Three-Benchmark Approach are Too Limiting.

In addition to restricting the availability of the three-benchmark approach, the railroads propose unnecessary limits on comparable traffic that threaten the viability of the approach itself. Specifically, the railroads argue that the comparable traffic automatically should exclude contract traffic and any other commodities no matter how similar their transportation characteristics may be to the issue traffic. Dow opposes any restrictions by fiat.

Contracts can be, and in today's rail markets usually are, comparable to common carrier traffic. The best evidence of this is the fact that the railroads themselves no longer draw significant distinctions between the two. The railroads are moving much of their contract traffic to tariff. Moreover, when they do still enter into contracts, those contracts are typically for short terms and frequently look like tariffs and/or incorporate wholesale tariff provisions into the contract. If the railroads want to exclude contracts from the comparable traffic group, they should be required to do so on the facts of the specific contracts, which they also must be willing to produce in discovery, so the complainant may make its own assessment of comparability.

Commodities need not be identical to be comparable. While not all commodities within the same two-digit STCC will be comparable, some may be comparable. Indeed, most of the chemicals that Dow produces have very similar transportation characteristics. This is another issue that should be reserved for a case-by-case determination.

In some cases, it may be very difficult to identify a sufficient number of comparable movements from the waybill sample to apply the three-benchmark approach. Therefore, it is imprudent to exacerbate this potential problem by arbitrarily excluding by fiat traffic that may in fact be comparable.

IV. Eligibility Thresholds Must Be Realistic.

The eligibility thresholds proposed by the Board and supported by the railroads are entirely unrealistic. Unless they are raised to more realistic levels and predicated upon reasonable assumptions, these thresholds effectively will deny shippers adequate regulatory rate protection regardless what approach the Board may adopt to determine reasonableness.

A. The Railroads Have Proposed A Reasonable Alternative To Calculating The MVC.

In its opening comments, Dow pointed out that it was unreasonable to equate the actual value of a rate case ("AVC") with a maximum value of the case ("MVC") based upon the jurisdictional threshold because a reasonable rate could, and likely would, be above the MVC for many, and perhaps most, commodities. Therefore, the jurisdictional threshold would overstate the AVC.

In their reply comments, however, several railroad commenters have made a proposal that could be an acceptable foundation for addressing Dow's concern. Namely, the railroads have suggested allowing the complainant to specify the AVC of its case for purposes of determining eligibility to use the small case standards, if the complainant is willing to accept its election as the MVC for purposes of rate relief.

It is unclear, however, whether the railroads' proposal is to allow the complainant to define the maximum value of its case or the maximum R/VC ratio for its movement. *Compare* BNSF Reply at 10-11 *with* AAR Reply at 11-12. Dow supports the former, but not the latter. Thus, for example, if an MVC of $500,000 was predicated upon a rate reduction of $100/car multiplied by 1000 cars annually for 5 years, the complainant would be entitled to rate relief up to a MVC of $500,000 over 5 years regardless whether it moved more or less than 100 cars in any single year.

Dow believes such a proposal is a reasonable solution to its concerns, but only if the complainant possesses all available information for it to make a fair assessment of the actual value of its case. Thus, for the three-benchmark approach, the complainant must have access to the costed waybill sample prior to filing its complaint so that it may identify comparable traffic in order to generate a reasonable estimate of its potential rate relief. Moreover, the complainant must have access to the unmasked revenues, or its estimates will be skewed either too high or too low. It would be arbitrary to bind the complainant to an estimated case value that is based upon masked revenues.

B. Eligibility Should Be Based Upon Reasonable Litigation Cost Estimates Multiplied By A Risk Factor.

1. A risk factor is needed to allow plaintiffs the opportunity, but not the guarantee, to do better than break-even.

The railroad commenters have criticized Dow and other shippers for including a risk factor in determining the eligibility thresholds. They assert that a risk factor requires a subjective assessment of a complainant's likelihood of success and that it insulates complainants from downside risks. But the railroads either misunderstand or deliberately distort the role of a risk factor.

A risk factor is required to ensure that complainants who qualify to use the small case standards have the opportunity to obtain meaningful relief. The Board's proposed eligibility thresholds are set at or below a complainant's likely litigation costs. Consequently, a complainant's most likely litigation scenario is to break even by recovering its litigation costs, but no more, and probably less. In that circumstance, no shipper will ever file a complaint under the small case standards.

A risk factor of three multiplied by a realistic estimate of litigation costs would generate a reasonable eligibility threshold. For example, based upon the Board's estimated Full-SAC litigation cost of $3.5 million, a shipper would be required to use Full-SAC if its MVC exceeds $10.5 million over 5 years. Dow believes that any case with an MVC below that level should qualify to use the three-benchmark approach. However, if the Board were to adopt SSAC over shipper objections, the Board should multiply a reasonable litigation cost by a risk factor of three in order to determine the floor above which a plaintiff must use SSAC. Anything below that would qualify then to use the three-benchmark approach.

Contrary to the representation of railroad commenters, the risk factor does not require any assessment of the likelihood of success in any individual case, nor does it insulate shippers from litigation risk. Shippers still assume the risk that they may not obtain any rate relief or may obtain less relief than anticipated. In either case, the shipper still incurs its litigation costs and is not guaranteed any result. The risk factor merely provides shippers with the opportunity, but not the guarantee, to do better than break-even.

2. Eligibility thresholds must reflect the ability and incentive of railroads to increase litigation costs.

The Board's litigation cost estimates discount the ability and incentive of railroads to increase such costs. The railroads' protests that they have no such incentives because their litigation costs would increase too are not credible.

Each rate case has greater value to a railroad than just the potential revenue reduction for the issue traffic. Its precedential value alone could justify litigation costs to the railroad greater than the value of the case to the plaintiff, since adverse precedent could influence the results in future cases, or even discourage such cases altogether.

The ability to increase a plaintiff's litigation costs also can be the strongest deterrent to future cases. The gain from avoiding future litigation can generate a substantial return to the railroad for the small price of over-litigating a single case.

The railroads have an incentive to underestimate litigation costs in setting the eligibility threshold because that will shift more potential cases into the more costly SSAC and Full-SAC standards, thereby discouraging many truly small cases. Therefore, the Board must take account of this fact in setting eligibility thresholds. One way to do so is through a risk factor applied to otherwise reasonable litigation costs.

3. The aggregation rule is a prejudicial response to a very minor risk.

The railroads support the aggregation rule as necessary to prevent "gaming" by shippers who might separately challenge multiple movements in order to avoid a Full-SAC analysis. But there is no evidence that many shippers even would have the ability, much less the incentive, to "game" the eligibility thresholds in this manner.

The aggregation rule is predicated upon an assumption that is unsupported by actual experience. If shippers could economically justify a Full-SAC case today for aggregated movements, presumably a few such Full-SAC cases already would have been filed over the past 20 years. The most analogous aggregated Full-SAC cases, *McCarty Farms* and *FMC Wyoming*, have demonstrated the greater cost, complexity, and ultimately the futility of such a Full-SAC case. Thus, shippers who may choose to separately challenge individual movements can claim that Full-SAC is too complex and costly given the value of the case, which is all that the statute requires to be eligible to use the small case procedures.

The aggregation rule also is unfair to shippers because it requires them to know all of their potential movements up to two years in advance. But, as Dow explained in its opening comments, shippers frequently cannot know that information. In this situation, the aggregation rule still would require a shipper to use the Full-SAC standard for a movement that otherwise would qualify as a small case, even though there is no way the shipper could be "gaming" the system.[3]

Even in situations where "gaming" might be possible, it is not at all clear that shippers would benefit substantially, if at all, by disaggregating their individual movements. Multiple cases require substantial duplication of time and effort for speculative gains, since there is no demonstrated advantage to results from the three-benchmark or SSAC approaches over the Full-SAC approach.

Finally, while the Board expresses "gaming" concerns as to shippers, it does not acknowledge, much less attempt to address, potential "gaming" by railroads. But, the railroads have a greater ability, through their control over the tariff rate, to influence the factors in the MVC calculation than shippers. The railroads, however, deny that they have any incentive to use

[3] UP makes the absurd claim that shippers would not be denied relief in this situation, since they still could file a Full-SAC challenge to the rate. UP Reply at 64, note 208. But, this ignores the fact that Full-SAC would be too costly given the value of the case.

the tariff rates to "game" the MVC. But, their incentive to "game" is no less than the shippers' incentive to do so, and their ability certainly is greater than the shippers' ability.

V. Shippers Require Even Greater Regulatory Protection in Today's Rail Markets.

The need for effective and meaningful regulatory constraints on railroad pricing is greater in today's rail market than it has been in the post-Staggers regulatory environment, and perhaps since the days of the railroad barons. Capacity constraints have given railroads unprecedented pricing leverage even on their competitive traffic. This fact requires a heightened level of vigilance against monopoly abuse of captive traffic.

The railroads claim that the current market simply reflects the laws of supply and demand at work. But, the laws of supply and demand work very differently in competitive and monopoly markets. In a truly competitive market, the higher prices caused by supply shortages will attract new entrants with additional supply that will decrease prices. Since barriers to entry preclude new railroad entrants, additional capacity must come from the incumbent railroads. But, the incumbent railroads have very little incentive to add sufficient capacity to meet demand, since to do so would reduce revenue below the profit maximizing levels for a monopolist. Thus, while rates may decline with additional capacity, they will not decline to the same levels as a truly competitive market.

The railroads also contend that shippers such as Dow do not need protection from unreasonable rates. This contention is predicated upon the market capitalization of Dow compared to the railroads. But, there is no demonstrated link between this factor and monopoly abuse. Dow's large production facilities in North America at Freeport, Texas; Plaquemine, Louisiana; and Taft, Louisiana are captive to a single railroad, UP. This constrains not only direct modal competition, but also any limited amount of geographic competition that may exist.

It does not matter how big Dow is relative to UP when UP maintains such control over Dow's distribution channels.

The railroads suggest that, since Dow and similarly situated shippers have not filed a single rate case in ten years, it strains credulity that they have been subject to market abuse. The Board should not interpret the lack of small rate cases in the past to be a sign that rates have been reasonable. The fact is that the uncertainty of the small case standards have chilled virtually any small rate cases. Moreover, whether rate protection was necessary in the past says nothing about whether such protection is required in today's capacity-constrained rail market.

Respectfully submitted,

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January 11, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have on this 11th day of January, 2007, served a copy of the foregoing Rebuttal Comments on all parties of record, by first class mail, postage prepaid.

Kimberly Murray